

### **III. THE COMMISSION SHOULD REAFFIRM THAT INCUMBENTS ARE NOT REQUIRED TO PROVIDE UNBUNDLED ACCESS TO ADVANCED SERVICES FACILITIES.**

As it did in the *UNE Remand Order*, the Commission should decline to require unbundling packet-switches and other advanced services facilities. Such restraint is necessary to encourage the construction of broadband networks. As the Commission has recognized, the deployment of a broadband network entails more risk than traditional networks, and even the possibility of unbundling requirements adds uncertainty and costs that discourage deployment. To the extent such unbundling is technically feasible, which it frequently is not, it substantially increases the cost of deployment. Moreover, given Qwest's experience in implementing past unbundling mandates in connection with advanced services, it is unlikely that the ILECs will come close to recovering the additional costs they incur due to unbundling.

Imposing unbundling requirements on advanced services would also accentuate the current asymmetric regulation of ILECs' broadband services versus their intermodal competitors. The Commission has already decided that cable modem service is not a telecommunications service and therefore is not subject to unbundling requirements.<sup>103/</sup> Given that DSL service has a smaller market share than cable modem, it would make no sense to impose unbundling requirements on facilities used by ILECs to provide DSL service. Indeed, doing so would only increase the current regulatory asymmetry between cable modem, satellite, and fixed wireless competitors and ILECs, who are already subject to various wholesale and broadband regulations that do not apply to cable modem, satellite, and fixed wireless competitors. Particularly given

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<sup>103/</sup> Declaratory Ruling and Notice of Proposed Rulemaking, *Inquiry Concerning High-Speed Access to the Internet Over Cable and Other Facilities; Internet Over Cable Declaratory Ruling; Appropriate Regulatory Treatment for Broadband Access to the Internet Over Cable Facilities*, GN Docket No. 00-185 and CS Docket No. 02-52, FCC 02-77 (rel. March 15, 2002).

growing competition in advanced services, the Commission should move to rationalize its current disparate regulation of broadband services, and thereby encourage further facilities-based competition for broadband services.<sup>104/</sup>

**A. CLECs Have Not Been, and Would Not Be, Impaired Without Unbundled Access to Advanced Services Facilities.**

Qwest and the other ILECs are no more “incumbent” than any other carriers when it comes to advanced services. As former FCC Chairman William Kennard noted, “[a]ll companies are new entrants when it comes to [broadband] services[.]”<sup>105/</sup> In this respect, these new network facilities fall outside the scope of the market-opening objectives of section 251.

**1. Packet Switching and DSL**

The Commission should continue to reject the unbundling of packet switches (e.g., ATM and frame relay) or electronics used in connection with the provision of DSL. The Commission previously declined to require the unbundling of these facilities<sup>106/</sup> and ensuing developments have only provided additional support for that decision. The Commission found in the *UNE Remand Order* that “[m]arketplace developments . . . suggest that requesting carriers have been able to secure the necessary inputs to provide advanced services to end users in accordance with

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<sup>104</sup> For purposes of these comments, we do not consider the regulatory and statutory classification issues with respect to broadband services that the Commission has raised in the Broadband proceeding, including the question whether broadband Internet access is an information service and whether the transmission used in connection with that services is a telecommunications service, or telecommunications. See Notice of Proposed Rulemaking, *Review of Regulatory Requirements for Incumbent LEC Broadband Telecommunications Services*, 16 FCC Rcd 22745 (2001).

<sup>105</sup> Chairman William E. Kennard, A Broad(band) Vision for America, Remarks to the Federal Communications Bar Association (June 24, 1998), *available at* <<<http://www.fcc.gov/Speeches/Kennard/spwek819.html>>>.

<sup>106</sup> *UNE Remand Order* ¶¶ 302-17.

their business plans. This evidence indicates that carriers are deploying advanced services to the business market initially as well as the residential and small business markets.”<sup>107/</sup> Such marketplace evidence has grown stronger over time. Since the *UNE Remand Order*, the number of installed CLEC packet switches has essentially doubled to 1700, and the average number of packet switches per MSA has grown by approximately 150 percent in the top 100 MSAs.<sup>108/</sup> Indeed, the largest providers of frame relay and ATM services are AT&T, WorldCom, and Sprint, rather than any of the ILECs.<sup>109/</sup>

Moreover, the ILECs have no scale advantages when they roll out these new networks. According to the Commission’s latest estimates, cable modem providers have approximately 64 percent of the residential and small business broadband market,<sup>110/</sup> while DSL providers in the aggregate have a share of approximately 34 percent.<sup>111/</sup> Nor is there any evidence that DSL will gain a dominant market share in the foreseeable future, as the Commission itself has noted.<sup>112/</sup> Indeed, analysts have predicted that by year-end 2002, cable modem providers will, in the

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<sup>107/</sup> *Id.* ¶ 307.

<sup>108</sup> *UNE Fact Report* at II-23 to II-24.

<sup>109</sup> *Id.* at II-24; *see also* Comments of Qwest Communications International Inc., *Review of Regulatory Requirements for Incumbent LEC Broadband Telecommunications Services*, CC Docket No. 01-337, at 4 (filed Mar. 1, 2002).

<sup>110</sup> Third Report, *Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion, and Possible Steps to Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996*, CC Docket No. 98-146, FCC 02-33, App. C, Table 3 (rel. Feb. 6, 2002) (“*Third Advanced Services Report*”).

<sup>111</sup> *Id.* The aggregate share for ILEC DSL services is even less, as the 34 percent share is for all providers of DSL and includes “other wireline” services, which are not all DSL services. Wireless and satellite providers held approximately 2 percent combined. *Id.*

<sup>112</sup> *See id.* ¶ 63.

aggregate, have approximately 9.6 million subscribers, while DSL providers will have fewer than 6 million.<sup>113/</sup> In view of the Commission's ruling that cable modem service is not a telecommunications service and therefore not subject to section 251 unbundling requirements, imposing such requirements, and the resulting costs, on DSL facilities would only handicap DSL's ability to compete with cable modem service. Such an outcome is unjustifiable in view of the relative market shares of the two services.

Thus, the impairment analysis for advanced services facilities starts from a much different place than the Commission's analysis of other network elements, where it was sometimes presumed that unbundling was necessary to eliminate any advantages based on ILECs' economies of scale. In short, incumbents do not possess significant economies of scale when they deploy advanced services facilities.<sup>114/</sup>

## **2. Line Sharing and Fiber Deployment**

The Commission also should not expand line sharing requirements, especially to fiber. Line sharing has been a failed experiment. Qwest has spent large sums to allow for unbundled access to the high frequency portion of the loop as required by the Commission, but to date has been able to recover only a fraction of those expenditures because of low CLEC demand, as well as the way in which TELRIC has been applied in this context. Qwest spent approximately \$12.3 million for network and OSS changes, but fewer than .05% of its network access lines are currently being shared. Although Qwest does not oppose grandfathering current locations where

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<sup>113</sup> Yankee Group, Cable Modem Providers Continue to Lead the High-Speed Internet Charge: The Yankee Group's Predictions on Consumer Broadband Services (August 2001); Yankee Group, Broadband Access Technology: Whose Number is Up? (September 2001).

<sup>114</sup> See *UNE Remand Order* ¶ 308 ("It . . . does not appear that incumbent LECs possess significant economies of scale in their packet switches compared to the requesting carriers.")

it has already deployed line sharing capability,<sup>115/</sup> this requirement should not be extended to new locations or technologies. The fact that CLECs have rarely used this capability alone demonstrates that they would not be impaired without access to it.

Moreover, the availability of dark fiber loops (as well as subloop unbundling) provides CLECs an alternative means of providing advanced services. New architectures that involve extending the reach of fiber “to the curb” or even “to the home” can take at least three forms — “overlay” facilities that supplement existing facilities, “replacement” facilities that completely replace existing facilities, and new construction/greenfield builds in an area that was not previously served.<sup>116/</sup> In the case of overlay facilities, which are more common than replacement facilities, the construction of the new facilities does not in itself alter a CLEC’s ability to provide services using the preexisting network. CLECs could continue to provide POTS, DSL, or any other telecommunications service via unbundled copper loops in the same manner they provided these services prior to the construction of the new network. Likewise, a CLEC could continue to provide its chosen services through line sharing over copper loops or by obtaining a copper subloop in the preexisting network architecture. Thus, lack of unbundled access to a new overlay network would not raise competing carriers’ entry costs or otherwise diminish their ability to provide the services they seek to provide.

Reasonable transitional arrangements could be required to maintain the availability of copper loops in the case of overlay deployments. Qwest does not proactively remove copper facilities in the case of an overlay. The placement of fiber rarely *accelerates* the retirement of

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<sup>115</sup> This assumes, of course, that the D.C. Circuit Court of Appeals upholds the Commission’s *Line Sharing Order* on appeal.

<sup>116</sup> Notice ¶ 50.

copper facilities. Thus, existing services or products being purchased by a CLEC should not as a factual matter be jeopardized by a change in technology.

In the case of replacement or new construction/greenfield builds, a CLEC would have a variety of options. To the extent a CLEC wants to provide voice service, Qwest could hand off a voice grade circuit at the central office to the CLEC. A CLEC wishing to provide advanced services could purchase dark fiber to the central office (at UNE rates) and simply add its own electronics to light the fiber; as the Commission found with respect to DSLAMs, CLECs are not impaired without access to ILEC electronics. In addition, to the extent that the loop in question contained any copper (e.g., from the “curb” to the home), Qwest would unbundle that subloop. Thus, by leasing dark fiber loops or subloops from the ILEC and providing its own electronics, the CLEC could effectively duplicate the ILEC’s ability to provide advanced and broadband services over a fiber (or primarily fiber) loop.

Of course, carriers could also choose to self-provision facilities to provide broadband and other telecommunications services, especially in new construction/greenfield builds because the CLEC can build at the same time as the ILEC. That is exactly what the ILECs’ cable, wireless, and satellite competitors have done.

**B. Requiring Unbundled Access to Advanced Services Facilities Would Deter Facilities-Based Competition for Broadband Services and Deployment of Broadband Facilities.**

When the Commission declined to unbundle packet switching, except in limited circumstances, in the *UNE Remand Order* it said it did so in order not to “stifle burgeoning competition in the advanced services market.”<sup>117</sup> The Commission further recognized that “regulatory restraint” was prudent to further the Act’s goal of encouraging facilities-based

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<sup>117</sup> *UNE Remand Order* ¶ 316.

investment and innovation.<sup>118/</sup> That logic is just as valid today as it was three years ago.

Imposing unbundling obligations on the ILECs' advanced services will deter such deployment and undermine the ability of Qwest and other ILECs to raise capital for new infrastructure.<sup>119/</sup>

It is critical that such broadband deployment occur now. The construction of broadband networks in general is a fundamental national interest. Moreover, it is particularly important for Qwest and other ILECs to undertake such deployment, given the limitations of the existing telephone network and the need to promote effective competition to cable modem providers. Today, ILECs provide broadband services to residential and small business customers primarily through DSL services. While these services can provide broadband access to many telephone customers, distance limitations and other technical constraints of DSL prevent it from being available to all customers without major upgrades to existing telephone plant. According to Commission statistics, as of June 2001, seventy percent or more of U.S. households could obtain cable modem service,<sup>120/</sup> but DSL services were available to only 45 percent of customers.<sup>121/</sup> In Qwest's territory DSL is available to only 36 percent of residences and businesses. Massive investment is needed to overcome these current limitations and substantially increase the availability of broadband services to potential customers. Qwest and other incumbents will

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<sup>118</sup> *Id.*

<sup>119</sup> See Haring & Shooshan at 9 ("If a competitor is compelled to share (prematurely or unremuneratively) the fruits of its efforts to advance technology and produce better products and service capabilities, its ability to appropriate economic rewards from such efforts and, hence, its economic incentives to undertake such efforts will be attenuated with adverse consequences for the vigor of competition and the dynamism of the competitive process.")

<sup>120</sup> *Third Advanced Services Report* ¶¶ 46, 51.

<sup>121</sup> *Id.* ¶ 51. Notably, satellite service is available virtually anywhere in the United States. See *UNE Fact Report* at IV-22.

undertake such investment, however, only to the extent the attendant risks are outweighed by the expected return.

By their nature, investments in facilities to provide broadband services are more risky than investments in well-established markets.<sup>122/</sup> These risks are of various types. On the whole, demand for broadband services is very uncertain. Today, only about 10 percent of customers who can get broadband services actually take it. Some have theorized that the take-rate for broadband services will increase with the development of a so-called “killer app,”<sup>123/</sup> but no one knows if that is true or, if so, when that will occur.<sup>124/</sup> In addition, given steady competition from cable modem providers, and growing competition from satellite and fixed wireless providers, demand for DSL services in particular is uncertain. Finally, the rapid evolution of broadband technologies creates a risk that an incumbent deploying a new network will not be able to recover its investment due to technical obsolescence. Such obsolescence could be caused either by newer cheaper technologies that allow other carriers to undercut the price of services based on the ILEC’s deployed technology, or by technologies that are functionally superior, such as ones that provide higher bandwidth. Indeed, DSL has been referred to as a “transitional” technology, in part because (at least today) it generally is not capable of the bandwidth that many believe will eventually be demanded by broadband users. As fiber is extended closer to end

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<sup>122</sup> *UNE Remand Order* ¶ 314.

<sup>123</sup> *UNE Fact Report* at V-25 to V-26.

<sup>124</sup> On the other hand, higher demand for broadband in other countries provides hope for a similar trend in the U.S. See generally Third Report, *Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable And Timely Fashion, and Possible Steps To Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996*, CC Docket No. 98-146, FCC 02-33, ¶¶ 127-29 (rel. Feb. 6, 2002).



users, current technologies will likely be supplanted by more advanced technologies that carry higher bandwidths. All indications are that such additional capacity will be necessary for routine use of many broadband applications.<sup>125/</sup>

The application of unbundling requirements to these new deployments would further increase the risks associated with these investments by adding significant additional costs that likely cannot be recovered. In this context, unbundling obligations would increase operating costs, require network changes to allow for unbundling (assuming it is technically feasible), and entail expensive operations support system upgrades that would otherwise not be necessary.

There is also no guarantee that an ILEC deploying such a network architecture would be able to recover these costs. In the past, Qwest has incurred large expenses to allow unbundled access to particular network elements as required by the Commission — and as demanded by CLECs — and then subsequently found that there is scant demand from CLECs for the unbundled functionalities. For example, in deploying remote terminals, Qwest spent millions of dollars to ensure the availability of collocation in 1,481 remote collocation sites consistent with the Commission's rules,<sup>126/</sup> yet, at this point in time, *only two of those remote terminal sites are being used by a CLEC*. Given these risks, Qwest and other ILECs are reluctant to invest in new broadband deployments.<sup>127/</sup>

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<sup>125</sup> See *UNE Fact Report* at IV-23, V-25 to V-26.

<sup>126</sup> Qwest spent approximately \$3400 per terminal to enlarge cabinets and resolve security and access concerns.

<sup>127</sup> See Letter from Thomas Tauke, Verizon, to Chairman Powell at 4 (filed Nov. 7, 2001 in CC Docket No. 96-98) ("The resulting uncertainty [over unbundling of line cards in remote terminals] is one of the key reasons that Verizon to this point has significantly constrained deployment of DSL capability in our remote terminals.").

Further aggravating the situation, a CLEC will have no reason to invest in facilities related to new services if it knows that it will have the right to obtain the requisite facilities at TELRIC rates from the incumbent: the CLEC can avoid the investment risks, while being assured that it will not suffer a competitive disadvantage vis-à-vis the incumbent since it can always utilize the incumbent's facilities if demand materializes.

Thus, it is essential that the Commission exhibit "regulatory restraint" with regard to unbundling requirements for advanced services. Such restraint is appropriate because the lack of unbundling obligations in this instance will not materially diminish CLECs' ability to provide the services they seek to offer. Moreover, even if CLECs were so impaired, such concerns are clearly outweighed by the need to encourage the deployment of broadband facilities.

**IV. THE COMMISSION SHOULD ACT PROMPTLY, AND NOT AWAIT THE CONCLUSION OF THIS DOCKET, TO CORRECT FUNDAMENTAL VIOLATIONS OF TELRIC THAT REMOVE INCENTIVES FOR CLECS TO INVEST IN ALTERNATIVE FACILITIES.**

In their initial discussion of this proceeding, members of the Commission indicated that this *Triennial Review* would consider both which elements should be subject to unbundling and whether and how TELRIC pricing should continue to apply to such elements.<sup>128/</sup> As Chairman Powell and Commissioner Martin recognized, it makes eminent sense to consider all of these unbundling issues together because they are so closely interrelated.<sup>129/</sup> The effect of unbundling

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<sup>128</sup> See Michael K. Powell, Digital Broadband Migration: Part II, Press Conference (Oct. 23, 2001) (noting that the *Triennial Review* would "be the principal docket for evaluating unbundled network policy, including access, ordering *and pricing*") (emphasis added).

<sup>129</sup> See Michael K. Powell, Remarks at the Association for Local Telecommunications Services (Nov. 30, 2001) ("Th[e] [*Triennial Review*] proceeding is designed to roll up a number of UNE issues that have been pressed upon us in piecemeal fashion. A comprehensive proceeding will allow us to examine the host of UNE related issues that have been swirling around."). Even after the *Notice* was issued, Commissioner Martin recognized the importance of examining pricing issues in connection with this proceeding:

requirements on both CLECs' and ILECs' investment incentives, for example, depends to a large extent on how the Commission's pricing rules are interpreted and applied. Thus, a comprehensive review of the unbundling rules would necessarily require an analysis of the pricing rules as well, and failure to undertake that analysis will mean that this proceeding is incomplete. Simply put, if UNE prices are not set properly, the unbundling regime will almost inevitably cause distortions in carriers' decisions as to whether to "make" or "buy" facilities and discourage the investment in facilities. As a result, the improper application of TELRIC that produces rates below forward-looking costs can be just as devastating to the prospects for facilities-based competition as deciding to require the unbundling of a UNE that is not necessary to create or maintain competition.

Qwest's experience over the past several years confirms that the need for Commission action with respect to UNE prices is at least as urgent as it is with respect to identifying and defining the elements that are subject to the unbundling requirements. Over the last several years, CLECs have urged with substantial success that the purpose of TELRIC is to develop the lowest prices possible so as to promote intramodal competition by resellers (and to the detriment of facilities-based competition and competitors). To achieve that end, they have distorted the most basic TELRIC principles to justify the use of cost models and inputs that bear no relationship to the TELRIC methodology as originally formulated by the Commission. CLECs

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[W]e ought to reexamine how our unbundling and/or pricing rules apply to incumbent deployment of new facilities. For example, once we have determined that a particular state's market "is fully and irreversibly open to competition," how is access to yet-unbuilt new facilities at super-efficient prices necessary to enable a new entrant to compete? — especially if existing facilities or their equivalent capacity are maintained at current prices. I look forward to examining these issues in our triennial review proceeding.

Kevin J. Martin, Remarks to the Federal Communications Bar Association (Feb. 1, 2002).

have been assisted in this endeavor by certain decisions by the Commission in other proceedings, notwithstanding the Commission's caution that these decisions do not apply to the determination of UNE prices. The Commission should therefore act promptly to (1) reiterate that the purpose of TELRIC is not to establish the lowest possible prices for resellers, but to send to new entrants the correct economic signals whether to build their own facilities or lease them from ILECs;<sup>130/</sup> (2) correct some of the more fundamental misapplications of TELRIC that CLECs have been urging in the states; and (3) clarify that certain decisions with respect to the cost model used to calculate the allocation of universal service support are not to be applied to determine UNE prices.

The Commission has explained that the "essential objective" of TELRIC "is to determine what it would cost, in today's market, to replace the functions of [a network] asset that make it useful," while simultaneously taking as given "the most basic geographical design of the existing network."<sup>131/</sup> By attempting to "replicat[e] . . . the conditions of a competitive market," TELRIC is intended to give CLECs appropriate price signals about when it would be efficient, and when inefficient, to build their own facilities rather than leasing elements from the incumbent.<sup>132/</sup> Such price signals can be accurate only if UNE prices reflect an accurate measure of forward-looking costs. Prices that are less than forward-looking costs inevitably create incentives for CLECs to rely on UNEs in at least some cases where it would be more economically efficient for them to invest in their own facilities; thus, below-cost prices inevitably slow, and in some cases prevent,

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<sup>130/</sup> See Haring & Shooshan at 25-26, 33.

<sup>131</sup> Brief for Petitioners FCC and United States, *Verizon Communications Inc. v. FCC*, No. 00-511 and consolidated cases, at 6, 9 (U.S. April 2001) (emphasis added).

<sup>132</sup> *Local Competition Order* ¶ 679; see also *id.* ¶¶ 620, 683-85.

the development of facilities-based competition. Moreover, incumbents have significantly less incentive to invest in new facilities and take on the risks associated with substantial (and often sunk) investment in facilities to the extent that they have to turn around and share those facilities with their competitors at prices at or below cost, especially when state commissions, as they often do, fail to account for the relevant competitive and regulatory risks in determining the cost of capital.

Even when TELRIC is properly and reasonably applied, the continued disconnect between retail prices and costs skews competitive entry decisions of CLECs and creates opportunities for regulatory arbitrage.<sup>133/</sup> For example, since retail rates for business customers are usually well above cost, CLECs that want to serve such customers without deploying their own facilities have every reason to use the ostensibly cost-based UNE-P rather than resale. And of course the incentives are reversed in the case of residential customers whose retail rates tend to be below cost.

Perhaps more significantly, the implicit subsidies that are inherent in ILECs' regulated rate structure create significant pressures on state commissions to distort TELRIC in an effort to prime the pump for economically inefficient UNE-based competition.<sup>134/</sup> CLECs insist to state commissions interested in at least the appearance of residential competition that, in view of the below-cost retail residential rates, the only way to make it "sufficiently profitable" for CLECs to serve residential customers is to lower UNE rates dramatically. But lowering UNE rates so as to permit CLECs to "match" ILECs' below-cost residential rates necessarily requires distorting

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<sup>133</sup> See Haring & Shooshan at 27-31, 33-34.

<sup>134</sup> See *id.* at 27-31.

TELRIC so that it no longer even comes close to “represent[ing] the incremental costs that incumbents actually expect to incur in making network elements available to new entrants.”<sup>135/</sup>

One form of such distortion occurs when states mix and match historical and forward-looking inputs based on which input happens to produce the lower cost. For example, when determining the percentage of structure sharing to assume in costing out a replacement network, state commissions have looked to, not how much it would cost an efficient carrier to build a replacement network *today* as TELRIC requires, but how much it would have cost that carrier to build a replacement network *many years ago*, before present-day buildings and other obstructions were built in developed areas and before other utilities had already deployed most of their own facilities.<sup>136/</sup> As a result, states have assumed much greater structure sharing (and therefore lower costs) than would occur today, when utilities already have placed their cables along the majority of routes a new entrant would build. Similarly, in an effort to lower UNE rates, some states have disregarded the costs of the more expensive cable placement methods and restoration required when placing cable in already-developed areas (as opposed to placing cable before buildings and roads have been built),<sup>137/</sup> even though a carrier reconstructing the network clearly would have to bear those costs today and in the future. Decisions such as these directly

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<sup>135</sup> *Local Competition Order* ¶ 685.

<sup>136</sup> See, e.g., Phase II Opinion and Order, *Investigation into Qwest Corporation's Compliance with Certain Wholesale Pricing Requirements for Unbundled Network Elements and Resale Discounts*, Docket No. T-00000A-00-0194, at 12-14 (Ariz. Corp. Comm'n 2002) (“*Phase II Opinion and Order*”).

<sup>137</sup> See, e.g., *id.* at 11-12.

contradict TELRIC's requirement to calculate the costs an efficient carrier would incur to build a replacement network *today*.<sup>138/</sup>

A number of state commissions have also applied this Commission's *Inputs Order* in the universal service docket as a means of determining UNE prices, ignoring the Commission's warnings against doing so. The Commission has emphasized that its Synthesis Model modeling assumptions for universal service purposes "may not be appropriate to use" in "determining prices for unbundled network elements," and it has specifically "caution[ed] parties from making any claims in other proceedings based upon the input values we adopt" in the universal service setting.<sup>139/</sup> That is because, among other considerations, the objective of the *Inputs Order* was simply to determine *relative* differences in costs among states for purposes of determining which states receive federal universal service funding; the quite different objective of a UNE rate proceeding is to determine the *absolute* cost of replacing network elements. In fact, as the Commission itself has observed, any given error in its universal service cost model — even a significant one — may well have no material effect on the output of that model, because the same error, applied to different states, may largely cancel itself out in the course of the comparative analysis.<sup>140/</sup> In contrast, the same error, used within a different model designed to

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<sup>138</sup> *Id.* at 6. *Local Competition Order* ¶ 683 (stated goal of TELRIC is to "consider the costs that a carrier would incur *in the future*") (emphasis added); *id.* ¶ 685 (TELRIC costs are to be based on a "reconstructed local network").

<sup>139</sup> Tenth Order on Reconsideration, *Federal-State Joint Board on Universal Service*, 14 FCC Rcd 5983 ¶ 31 n.66, ¶ 32 ("*USF Inputs Order*"); *accord New York 271 Order* ¶ 245.

<sup>140</sup> See Brief for Respondents FCC and United States, *GTE Serv. Corp. et al. v. FCC*, No. 99-1244, at 27 (filed Oct. 4, 2000), *petition for certiorari dismissed*, 531 U.S. 975 (2000); see generally Ninth Report and Order and Eighteenth Order on Reconsideration, *Federal-State Joint Board on Universal Service*, 14 FCC Rcd 20432 (1999), *rev'd sub nom. Qwest Corp. v. FCC*, 258 F.3d 1191 (10<sup>th</sup> Cir. 2001).

set individual UNE rates based on *absolute* forward-looking costs, may have enormous consequences.

Nevertheless, CLECs have argued that the assumptions in the *Inputs Order* are directly applicable in state cost proceedings. For example, in a recent proceeding in Arizona, CLECs argued that the interpretation of TELRIC assumptions in the *Inputs Order* provided “ample basis” for the assumptions in a recommended decision by the state commission. The CLECs contended that the state commission should disregard Qwest’s argument that “inputs used by the FCC in its model for calculating costs for universal service purposes may not be appropriate in other contexts,” because the purpose of the universal service proceeding was to determine the forward-looking costs of constructing a wireline local telephone network.<sup>141/</sup> The Commission needs to reiterate in clear terms that the Synthesis Model inputs adopted for universal services purposes may not be used to set UNE prices.

The Commission will not be able to ensure that its unbundling rules provide the appropriate incentives for both CLECs and ILECs and promote the goals of the 1996 Act, as the Commission is attempting to do in this proceeding, unless the Commission addresses these types of misapplication of UNE pricing rules by state commissions. Unfortunately, the only context in which the Commission currently addresses TELRIC pricing is in reviewing section 271 applications, a context in which the Commission’s purpose is limited to identifying UNE rates that exceed the reasonable range that would be produced by the proper application of TELRIC. Obviously, this process is not designed to identify and correct UNE prices that have been set too

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<sup>141/</sup> Response of AT&T and XO to Qwest’s Exceptions, *Investigation into U S West Communications, Inc. ’s Compliance With Certain Wholesale Pricing Requirements for Unbundled Network Elements and Resale Discounts*, Docket No. T-00000A-00-0194, at 8 (Ariz. Corp. Comm’n Feb. 1, 2002); *see also Phase II Opinion and Order* at 17 (relying on USF Inputs Order in determining fill factors).



low due to misapplications of TELRIC. Thus, the section 271 process tends to act as a one-way, downward ratchet for TELRIC rates, and the Commission does not have a countervailing procedure to consider and correct TELRIC rates that are unreasonably low. The Commission should therefore, in this or a simultaneous proceeding, address the misapplications of TELRIC described above.

The Commission's "benchmarking" analysis in its Section 271 decisions, though well-intentioned, can exacerbate the trend toward "below TELRIC" rates. When reviewing an ILEC's UNE rates, the Commission requires the ILEC to show either that the state commission "correctly applied TELRIC principles in all instances" or that the resulting UNE rates are not higher than those in a state whose UNE rates were determined to be fully TELRIC-compliant in a section 271 proceeding.<sup>142/</sup> To date, the Commission has allowed the UNE rates from only a handful of states to be used as benchmarks. In recent section 271 orders, the Commission has found the state commission's application of TELRIC to be deficient in some way and then turned to its benchmark analysis to evaluate UNE rates in that state.<sup>143/</sup> In its benchmarking analysis, the Commission considers loop rates separately from non-loop rates and focuses its attention on any UNE rate that is higher than in the benchmark state, even if the other UNE rates are lower than in the benchmark state (and lower than even a reasonable application of TELRIC would produce).

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<sup>142</sup> See *Rhode Island 271 Order* ¶¶ 32, 37-38.

<sup>143</sup> In the *Pennsylvania 271* proceeding, the Commission found "that the Pennsylvania Commission generally followed basic TELRIC principles" but also relied on its benchmarking analysis to conclude that Verizon's UNE rates were TELRIC-compliant. *Pennsylvania 271 Order* ¶¶ 55-72.

This type of benchmarking analysis can be problematic in at least two ways. First, though the Commission adopted the benchmarking analysis as a way to preserve state commissions' discretion to set UNE prices within a reasonable TELRIC range (particularly where the state commission has made inconsequential errors in the application of TELRIC), benchmarking can have the opposite effect. Increasing reliance on benchmarking can preclude the adoption of UNE rates that exceed the rates in the benchmarking states but still fall within a reasonable TELRIC range. Second, there is no particular reason to believe that the UNE rates in the three current benchmark states are anywhere near the mid-point (much less the upper limit) of TELRIC reasonableness. Indeed, the UNE rates in these states may well be set below TELRIC, because ILECs do not use section 271 proceedings as forums to complain about low rates.<sup>144/</sup> Thus, the benchmarking process can only be expected to push rates down to noncompensatory levels.

Whether or not the Commission takes this opportunity to help avoid the methodological errors that produce below-cost UNE rates, the Commission at the very least must be conscious of the effects of its pricing rules, and states' application of those rules, in analyzing what elements should be subject to unbundling requirements in this proceeding. For example, the Commission should not conclude that, merely because CLECs have not yet deployed significant quantities of a particular network element, but instead are relying on the ILECs' UNE facilities, some barrier to deployment of that element must exist. While evidence of such deployment should be conclusive, the converse is not the case, specifically because of the distortions caused by some

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<sup>144</sup> Not surprisingly, CLECs have urged the Commission to select benchmarking states with the lowest possible UNE rates. See, e.g., *Massachusetts 271 Order* ¶ 28 & n.69 (noting that AT&T urged the Commission not to use New York as a benchmarking state because New York's UNE rates were higher than those in Texas, Kansas, and Oklahoma).

applications of TELRIC pricing. If CLECs can lease an element from an incumbent at dramatically understated rates (as is often the case under current interconnection agreements), those understated rates may well be dictating CLECs' choices, not other barriers such as scale economies, delays, or other impairments. Similarly, an ILEC that knows it might have to unbundle new advanced facilities to competitors below (or even at) cost will have a significant disincentive to take the risk associated with such new investment. Thus, failing to exempt such facilities from unbundling will dampen investment and deployment by ILECs.

## V. CONCLUSION

Marketplace evidence unequivocally demonstrates that, since the *UNE Remand Order*, CLECs have increasingly relied on self-provisioned or other non-ILEC facilities to provide local exchange service, and intermodal competition has rapidly developed to provide alternatives to ILECs' facilities and services. This evidence alone establishes that the unbundling obligations for circuit switching should be removed on a nationwide basis and for dedicated transport in markets that meet this Commission's pricing flexibility test. Moreover, particularly in view of the strong policy in favor of encouraging deployment of broadband facilities, the Commission should reaffirm and extend its decision not to require ILECs to unbundle facilities used to provide DSL and other advanced services. Finally, although the *Notice* does not mention the UNE pricing rules, the Commission must provide immediate guidance as to the interpretation of TELRIC so as to prevent further misapplications of TELRIC at the behest of CLECs and thereby permit the development of efficient facilities-based competition.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'Samir Jain', written over a horizontal line.

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April 12, 2002

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**CERTIFICATE OF SERVICE**

I, Carole Walsh, do hereby certify that on this 12th day of April, 2002, I have caused true and correct copies of the foregoing corrected version of the Comments of Qwest Communications International, Inc. to be served by hand delivery upon the following parties:

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Federal Communications Commission  
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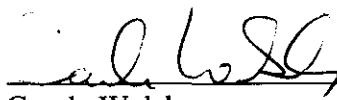
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